



GOVERNOR'S OFFICE OF  
BUDGET AND PROGRAM PLANNING

## Fiscal Note 2017 Biennium

<b>Bill #</b>	SB0374	<b>Title:</b>	Revise oil and gas tax rates and provide funding to local governments
<b>Primary Sponsor:</b>	Kaufmann, Christine	<b>Status:</b>	As Introduced

- |  |  |  |
|--|--|--|
| <input checked="" type="checkbox"/> Significant Local Gov Impact | <input checked="" type="checkbox"/> Needs to be included in HB 2 | <input type="checkbox"/> Technical Concerns              |
| <input type="checkbox"/> Included in the Executive Budget        | <input type="checkbox"/> Significant Long-Term Impacts           | <input type="checkbox"/> Dedicated Revenue Form Attached |

### FISCAL SUMMARY

	<u>FY 2016 Difference</u>	<u>FY 2017 Difference</u>	<u>FY 2018 Difference</u>	<u>FY 2019 Difference</u>
<b>Expenditures:</b>				
General Fund	\$273,000	\$0	\$61,250	\$0
State Special Revenue	\$1,650,828	\$10,209,865	\$12,802,171	\$13,950,514
<b>Revenue:</b>				
General Fund	\$1,650,828	\$10,209,865	\$12,802,171	\$13,950,514
State Special Revenue	\$1,650,828	\$10,209,865	\$12,802,171	\$13,950,514
<b>Net Impact-General Fund Balance:</b>	<u>\$1,377,828</u>	<u>\$10,209,865</u>	<u>\$12,740,921</u>	<u>\$13,950,514</u>

**Description of fiscal impact:** SB 374 creates a price trigger for the reduced working interest tax rate of 0.5% for oil and natural gas for the first 12 or 18 months of production in current law. This bill would tax the first 12 months of production from a vertical well and the first 18 months of production from a horizontal well at 9% if the price of West Texas Intermediate (WTI) crude oil in a calendar quarter is above \$52.59 per barrel. Additionally, the first 12 months of production from a vertical natural gas well and the first 18 months of production from a horizontal natural gas well would be taxed at 9% if the price of Henry Hub natural gas in a calendar quarter is above \$5 per million BTU's. Under this bill, the additional revenue generated from the increased tax rate when the price triggers are not met would be distributed 50% to the new community oil and natural gas impact relief account and 50% to the state general fund.

## FISCAL ANALYSIS

### Assumptions:

#### **Department of Revenue**

1. This bill creates a price trigger for natural gas production to qualify for the reduced working interest tax rate of 0.5% for the first 12 or 18 months of production. The average Henry Hub spot price of natural gas in a calendar quarter must be below \$5 per million BTU's for the 0.5% rate to be in effect.
2. This bill creates a trigger price for oil production to qualify for the reduced working interest tax rate of 0.5% for the first 12 or 18 months of production. The average price of WTI crude oil during a calendar quarter must be less than \$52.59 per barrel for the 0.5% tax rate to be in effect.
3. The bill directs the department to multiply the trigger prices listed in the bill by an inflation factor using the Consumer Price Index (CPI) each year by November 1. This provision goes into effect for tax year 2017.
4. This bill creates a community oil and natural gas impact relief account. The purpose of this account is to assist local governments needing to maintain and expand infrastructure and social services as a consequence of oil and gas development. The account would be administered by the Department of Commerce.
5. In quarters when the price of oil or natural gas is above the respective price triggers, this bill allocates 50% of the increased tax revenue from the 9% working interest tax rate to the community oil and natural gas impact relief account.
6. In quarters when the price of oil or natural gas is above the respective price triggers, this bill allocates 50% of the increased tax revenue from the 9% working interest tax rate to the general fund.
7. Using the conversion factor of 1.025 million BTU's equal to 1 MCF, the price trigger for natural gas proposed in this bill is equal to \$5.125 per MCF.
8. Using HJ 2 estimates of Henry Hub natural gas prices for FY 2016 and FY 2017 and OBPP's extrapolations for FY 2018 and FY 2019, the average Henry Hub price for FY 2016 through FY 2019 in chronological order would be \$3.86, \$4.25, \$4.65, and \$4.76 per MCF. This fiscal note assumes that the quarterly Henry Hub price for all quarters covered in this fiscal note is below \$5.125 per MCF (\$5 per million Btu's) and the 0.5% tax rate would be in effect.
9. Using HJ 2 estimates of WTI price per barrel for FY 2016 and FY 2017 and OBPP's extrapolations of those prices for FY 2018 and FY 2019, the average WTI price for FY 2016 through FY 2019 in chronological order would be \$78.45, \$86.81, \$96.42, and \$106.08 per barrel. This fiscal note assumes that the quarterly WTI price for all quarters covered in this fiscal note is above \$52.59 and the 9% tax rate would be in effect.
10. Using CPI figures from HJ 2 for FY 2016 and 2017 and assuming a constant rate of change for all years, the trigger prices would increase by approximately 1.83% for 2017, 2018 and 2019. This increase would not change the assumptions above.
11. The provisions of SB 374 state that only wells drilled after December 31, 2015 would be subject to the increased working interest tax rates when the oil and natural gas price is above the respective trigger price.
12. In an attempt to maintain consistency with the assumptions in HJ 2, it is anticipated that 72 horizontal oil wells and 24 vertical oil wells will be drilled annually for calendar years 2016 through 2019.
13. The HJ 2 assumptions for holiday oil production in FY 2016 and FY 2017 are not indicative of the amount of production that would be subject to the trigger price and higher tax rate provision in SB 374. Due to the spillover of holiday production from wells drilled before December 31, 2015 into both FY 2016 and FY 2017, the holiday production assumptions contained in HJ 2 for these two years must be adjusted in order to accurately reflect the holiday production resulting from those wells drilled after December 31, 2015.
14. The holiday oil production assumptions for FY 2018 and FY 2019 contained in HJ 2 do not need to be adjusted because holiday production in those years will be solely from wells drilled after December 31, 2015.
15. The following table shows the calculations for determining the increased tax revenue from oil production taxes in FY 2016 resulting from SB 374. The new tax rate would only be in effect for a small portion of FY

2016 holiday production, reflecting the amount of production coming from wells drilled during the last 6 months of FY 2016.

<b>FY 2016</b>		
<b>Determination of Revenue</b>	<b>Current Law</b>	<b>Proposed Law</b>
Holiday Oil Production	4,262,000	3,592,251
Qualifying Holiday Oil Production	-	669,749
Montana Oil Price	\$70.60	\$70.60
Holiday Working Interest Value	\$247,204,556	\$208,343,014
Holiday Working Interest Value of Qualifying Production		\$38,844,036
Working Interest Tax Rate	0.5%	0.5%
Working Interest Tax Rate for Qualifying Production	N/A	9.0%
Working Interest Tax Revenue	\$1,236,023	\$1,041,715
Working Interest Tax Revenue from Qualifying Production	N/A	\$3,495,963
SB 374 Increase in Revenue		\$3,301,655
<b>Distribution of Increased Revenue</b>		
General Fund (50%)		\$1,650,828
Community Oil and Gas Impact Relief Account (50%)		\$1,650,828

\*Qualifying production refers to output from wells drilled after December 31, 2015

16. The following table shows the calculations for determining the increased tax revenue from oil production taxes in FY 2017 resulting from SB 374. There is still some spillover holiday production in FY 2017 from wells drilled before December 31, 2015, and this production is taxed at the lower 0.5% rate.

<b>FY 2017</b>		
<b>Determination of Revenue</b>	<b>Current Law</b>	<b>Proposed Law</b>
Holiday Oil Production	4,251,000	508,125
Qualifying Holiday Oil Production	-	3,742,875
Montana Oil Price	\$78.13	\$78.13
Holiday Working Interest Value	\$272,841,820	\$32,613,391
Holiday Working Interest Value of Qualifying Production		\$240,231,922
Working Interest Tax Rate	0.5%	0.5%
Working Interest Tax Rate for Qualifying Production	N/A	9.0%
Working Interest Tax Revenue	\$1,364,209	\$163,067
Working Interest Tax Revenue from Qualifying Production	N/A	\$21,620,873
SB 374 Increase in Revenue		\$20,419,731
<b>Distribution of Increased Revenue</b>		
General Fund (50%)		\$10,209,865
Community Oil and Gas Impact Relief Account (50%)		\$10,209,865

\*Qualifying production refers to output from wells drilled after December 31, 2015

17. The following table shows the calculations for determining the increased tax revenue from oil production taxes in FY 2018 resulting from SB 374.

<b>FY 2018</b>		
<b>Determination of Revenue</b>	<b>Current Law</b>	<b>Proposed Law</b>
Holiday Oil Production	4,225,494	-
Qualifying Holiday Oil Production	-	4,225,494
Montana Oil Price	\$86.78	\$86.78
Holiday Working Interest Value	\$301,227,553	\$0
Holiday Working Interest Value of Qualifying Production	-	\$301,227,553
Working Interest Tax Rate	0.5%	N/A
Working Interest Tax Rate for Qualifying Production	N/A	9.0%
Working Interest Tax Revenue	\$1,506,138	N/A
Working Interest Tax Revenue from Qualifying Production	N/A	\$27,110,480
SB 374 Increase in Revenue		\$25,604,342
<b>Distribution of Increased Revenue</b>		
General Fund (50%)		\$12,802,171
Community Oil and Gas Impact Relief Account (50%)		\$12,802,171

\*Qualifying production refers to output from wells drilled after December 31, 2015

18. The following table shows the calculations for determining the increased tax revenue from oil production taxes in FY 2019 resulting from SB 374.

<b>FY 2019</b>		
<b>Determination of Revenue</b>	<b>Current Law</b>	<b>Proposed Law</b>
Holiday Oil Production	4,185,302	-
Qualifying Holiday Oil Production	-	4,185,302
Montana Oil Price	\$95.47	\$95.47
Holiday Working Interest Value	\$328,247,397	\$0
Holiday Working Interest Value of Qualifying Production		\$328,247,397
Working Interest Tax Rate	0.5%	N/A
Working Interest Tax Rate for Qualifying Production	N/A	9.0%
Working Interest Tax Revenue	\$1,641,237	N/A
Working Interest Tax Revenue from Qualifying Production	N/A	\$29,542,266
SB 374 Increase in Revenue		\$27,901,029
<b>Distribution of Increased Revenue</b>		
General Fund (50%)		\$13,950,514
Community Oil and Gas Impact Relief Account (50%)		\$13,950,514

\*Qualifying production refers to output from wells drilled after December 31, 2015

19. This bill results in contracted services for the department of \$273,000 in FY 2016 and \$61,250 in FY 2018 related to computer system modifications. These costs would be for redesigning the distribution model for oil and gas production taxes in FY 2016 and to revise the schedules for wells drilled prior to December 31, 2015 and validate and test the distribution in FY 2018.

20. This bill applies to oil and natural gas wells drilled after December 31, 2015, and to oil and natural gas produced and sold from those wells after December 31, 2015.

**Department of Commerce**

21. Section 1 of the bill provides the definitions that apply to the bill. Section 2 of the bill provides that the Department will receive grant applications from local governments for oil and gas impact projects; assist local governments in preparing cost estimates for projects; prioritize the project applications in accordance with the statutory priorities; prepare and submit to the governor a list of recommendations as to projects to be awarded grants and the amount of such grants; and report to each legislature the status of all uncompleted projects to which awards were granted. The bill provides that the Governor shall review the Department's recommendations and submit to the legislature a list of recommended project grant awards to be approved by the legislature.
22. Section 3 of the bill provides that authority for the Department to administer the funds in the community oil and natural gas impact relief account for the purposes of funding the oil and gas impact project program.
23. Section 4 of the bill provides the Department with the authority to adopt rules to implement the program.
24. The bill's effective date is 10/01/2015 and applies to oil and natural gas wells drilled after December 31, 2015.
25. Based on similar competitive grant programs currently administered by the Department, it is assumed the Department would immediately require 3.00 FTE to address the duties and responsibilities mandated in the bill. 2.00 pay band 6 FTEs would be required to serve as program specialists and 1.00 pay band 4 administrative support would also be required. For the 3.00 new FTEs the estimated costs for FY 2016 are \$101,490 and \$202,979 for FY 2017. FY 2018 and FY 2019 costs are inflated 1.5% annually.
26. For the purposes of this fiscal note it is assumed the Department's operating expenses would also increase. Staff would be expected to rank project applications, monitor grant awards and contracts, and periodically visit project sites. Operating expenses are estimated to be \$77,877 in FY 2016 and \$130,997 in FY 2017. FY 2018 and FY 2019 costs are inflated 1.5% annually. Additionally, it is further assumed that the grants authorized by SB 374 would be a separate biennial appropriation.

	<b><u>FY 2016 Difference</u></b>	<b><u>FY 2017 Difference</u></b>	<b><u>FY 2018 Difference</u></b>	<b><u>FY 2019 Difference</u></b>
<b><u>Fiscal Impact:</u></b>				
FTE	1.50	3.00	3.00	3.00
<b><u>Expenditures:</u></b>				
Personal Services	\$101,490	\$202,979	\$206,024	\$209,114
Operating Expenses	\$350,877	\$130,997	\$194,212	\$134,956
Grants	\$1,471,461	\$9,875,889	\$12,463,185	\$13,606,444
<b>TOTAL Expenditures</b>	<b><u>\$1,923,828</u></b>	<b><u>\$10,209,865</u></b>	<b><u>\$12,863,421</u></b>	<b><u>\$13,950,514</u></b>
<b><u>Funding of Expenditures:</u></b>				
General Fund (01)	\$273,000	\$0	\$61,250	\$0
State Special Revenue (02)	\$1,650,828	\$10,209,865	\$12,802,171	\$13,950,514
<b>TOTAL Funding of Exp.</b>	<b><u>\$1,923,828</u></b>	<b><u>\$10,209,865</u></b>	<b><u>\$12,863,421</u></b>	<b><u>\$13,950,514</u></b>
<b><u>Revenues:</u></b>				
General Fund (01)	\$1,650,828	\$10,209,865	\$12,802,171	\$13,950,514
State Special Revenue (02)	\$1,650,828	\$10,209,865	\$12,802,171	\$13,950,514
<b>TOTAL Revenues</b>	<b><u>\$3,301,656</u></b>	<b><u>\$20,419,730</u></b>	<b><u>\$25,604,342</u></b>	<b><u>\$27,901,028</u></b>
<b><u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u></b>				
General Fund (01)	\$1,377,828	\$10,209,865	\$12,740,921	\$13,950,514
State Special Revenue (02)	\$0	\$0	\$0	\$0

**Effect on County or Other Local Revenues or Expenditures:**

1. SB 374 would create additional fiscal capacity for local governments to maintain and expand infrastructure impacted from oil and gas development.

\_\_\_\_\_  
*Sponsor's Initials*\_\_\_\_\_  
*Date*\_\_\_\_\_  
*Budget Director's Initials*\_\_\_\_\_  
*Date*



## Dedication of Revenue 2017 Biennium

### 17-1-507-509, MCA.

- a) **Are there persons or entities that benefit from this dedicated revenue that do not pay? (please explain)**

Yes, the proposed program addresses the impacts of oil and gas development in Eastern Montana by increasing the rate of tax for qualifying oil and natural gas production. Taxes will be used to help address infrastructure issues in communities directly impacted by oil and gas development.

- b) **What special information or other advantages exist as a result of using a state special revenue fund that could not be obtained if the revenue were allocated to the general fund?**

A state special revenue account allows all expenditures and revenues related to the programs activities to be contained in a single accounting entity.

- c) **Is the source of revenue relevant to current use of the funds and adequate to fund the program activity that is intended? Yes / No (if no, explain)**

Yes.

- d) **Does the need for this state special revenue provision still exist?   X   Yes      No (Explain)**

Yes. A state special revenue account allows all expenditures and revenues related to the programs activities to be contained in a single account.

- e) **Does the dedicated revenue affect the legislature's ability to scrutinize budgets, control expenditures, or establish priorities for state spending? (Please Explain)**

No. While legislatively appropriated in HB 2, the funds in question are audited by the Office of the Legislative Auditor with any findings being presented to the Legislative Audit Committee.

- f) **Does the dedicated revenue fulfill a continuing, legislatively recognized need? (Please Explain)**

Yes. A state special revenue account should be established for the program proposed in SB 374 because all expenditures and revenues related to the programs activities would be contained in a single accounting entity.

- g) **How does the dedicated revenue provision result in accounting/auditing efficiencies or inefficiencies in your agency? (Please Explain. Also, if the program/activity were general funded, could you adequately account for the program/activity?)**

A state special revenue accounts makes it simpler to track the revenues and expenditures of the program as opposed to the general fund.